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No. 88-385

In The

Supreme Court of the United States

October Term, 1988

OFELIA RODRIGUEZ de QUIJAS, ET AL,

Petitioners,

vs.

SHEARSON/AMERICAN EXPRESS, INC.,
ITS SUCCESSORS AND ASSIGNS,

Respondents.

BRIEF OF PETITIONERS

DENIS A. DOWNEY
(Counsel of Record)
1185 F.M. 802, Suite 3
Brownsville, Texas 78521
(512) 544-0561

Attorney for Petitioners

January 9, 1989

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

QUESTIONS PRESENTED

1. Are claims under Section 12(2) of the 1933 Securities Act now arbitrable under predispute broker contracts?

2. If such claims are now arbitrable, may these Petitioners be compelled to submit such claims to arbitration pursuant to terms of a predispute contract executed at a time when Section 12(2) claims were clearly not subject to arbitration?

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OPINIONS BELOW

The opinion of the United States Court of Appeals for the Fifth Circuit is reported at 845 F.2d 1296. The order of the court of appeals denying petitioners' motion for rehearing en banc is reported at 850 F.2d 1582. The opinion of the United States District Court is unreported. All opinions are reproduced in the Appendix to the Petition for Certiorari.

JURISDICTION

The judgment of the court of appeals was entered on May 31, 1988 and motion for rehearing was denied on June 22, 1988. This Court has jurisdiction pursuant to 28 U.S.C. § 1254(1) (1982).

STATUTORY AND REGULATORY PROVISIONS INVOLVED*

United States Arbitration Act
- Section 2, 9 U.S.C. § 2
- Section 3, 9 U.S.C. § 3

Securities Act of 1933
- Section 12(2), 15 U.S.C. § 77l(2)
- Section 14, 15 U.S.C. § 77n
- Section 22(a), 15 U.S.C. § 77v(a)

Securities Exchange Act of 1934
- Section 10(b), 15 U.S.C. § 78j(b)
- Section 27, 15 U.S.C. § 78aa
- Section 29(a), 15 U.S.C. § 78cc(a)

STATEMENT OF THE CASE

Petitioners are part of a group of some seventeen first-time investors, most of who filed complaints in federal district court, Southern District of Texas, Brownsville

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* The text of these provisions is reproduced in full at Appendix A.

Division. A number of those complaints not directly involved here, are presently in such district court awaiting the outcome of this case.

All complaints are factually similar. Petitioners were minors, individuals without the ability to understand English, terminal cancer victims, recently widowed women or retirees. Life savings were withdrawn from bank accounts. Such investors had the most conservative investment needs. Each investor dealt with a Shearson broker named Jon Grady Deaton. Typically each was asked to sign a preprinted Shearson document which was presented face down. The portion facing the investor had two check marks where the investor was told to sign. On the side of the document facing down, in the last paragraph which began with a discussion of "successors," appeared not only an arbitration provision, but also a choice of law election. No explanation of any of the terms of these documents was attempted. Copies were not usually provided although frequently requested. The broker ultimately placed each investor in high risk, over-the-counter stock, wherein Respondent was frequently a market-maker and whose inherent investment risks were further magnified when each investor was placed on margin. All investors lost a significant portion or all of their life savings. Every trade was initiated by the broker. All investors repeatedly complained that the Shearson monthly statements were totally unintelligible. In every case the response was that the investor simply had to trust the broker. One of these Petitioners alleges that the broker came to her residence to explain her monthly statements and then committed a sexual assault. None of the investors was aware that the broker's supervisor frequently lent the broker large sums of money and had guaranteed a third-party investment loan of some $165,000.00. Nor was any investor aware that during the period of the investments the broker owed Respondent almost $195,000.00. When the broker disappeared in June of 1985, the status of the account of each Petitioner finally became known. Investors alleged causes of action under state common law, including sexual assault, and under

federal and state statutes. Initially complaints under § 12(2) of the 1933 Securities Act were ordered to be tried in federal district court, however the opinion of the Fifth Circuit Court of Appeals, which is the subject of this petition for certiorari, determined that such § 12(2) claims could be arbitrated.

Petitioners have never conceded that the customer documents which apparently each Petitioner signed are valid or enforceable and each Petitioner has further asserted that the district court, with jury, should try those basic contract issues.

Pursuant to the district court's order of November 18, 1986, Respondent submitted all claims with the exception of the § 12(2) claims, to arbitration. Default judgments were entered against the broker and he is not a party to this petition.

SUMMARY OF ARGUMENT

Under *Wilko v. Swan*, 346 U.S. 427 (1953), § 12(2) 1933 Securities Act claims may never be subjected to compulsory arbitration pursuant to pre-dispute broker contracts. Unless *Wilko* is expressly overruled by this Court or the relevant federal statutes are amended, Petitioners' § 12(2) claims must be litigated. Further, it is Respondent's burden to convince this Court that *Wilko* should be overruled.

Wilko should not be overruled for both statutory-specific policy reasons and for wider constitutional policy reasons. The legislative intent of the 1933 Act was definitively interpreted in *Wilko* to preclude forced arbitration of § 12(2) claims. The *Wilko* ratio, as reflected consistently in dozens of law review analyses and several hundred reported and unreported case opinions, including several of this Court, was that the forced arbitration of § 12(2) claims was not permissible because of the intent of Congress expressed in the 1933 Securities Act. Compulsory arbitration pursuant to a pre-dispute contract was determined to be *inherently* inconsistent with

such Congressional intent. There was no discussion in *Wilko* as to *quality* of then-extant arbitration proceedings.

Not only do Petitioners dispute the *relevance* of quality changes in arbitration recently suggested by this Court, Petitioners also dispute the *quantum* of improvement which Respondent, the Securities Industry, and various arbitration groups have alleged.

Wilko should not be overruled because this Court should not reverse itself on matters of federal statutory interpretation since Congress is always free to reverse federal legislative interpretation through the legislative amendment process. Petitioners' case does not present constitutional claims which are innately or practically beyond Congressional reformation.

Petitioners will also argue that if *Wilko* were to be, in effect, overruled, that such action should be taken only with respect to the *sophisticated* investor.

Finally, Petitioners will argue that either as a matter of contractual intent or as a matter of sound judicial policy that any alteration of *Wilko* should be made *prospective* only.

ARGUMENT

I. RESPONDENT HAS THE BURDEN OF PROOF IN THIS CASE

The conventional analytical thesis which has been accepted is that in *Wilko* there existed two federal statutes which were viewed in 1953 by the majority of that Court as being difficult to reconcile. Upon examination of relevant statutory provisions and relevant legislative histories, the later 1933 Securities Act was deemed to render invalid a pre-dispute agreement to arbitrate 12(2) claims.

The threshold and weighty task for Respondent[1] is to show that the *Wilko* court was wrong either because its

[1] "The doctrine of stare decisis imposes a severe burden on the litigant who asks us to disavow one of our precedents. For that doctrine not only plays an important role in our orderly adjudication, it also serves the broader societal interests in even-handed, consistent and predictable application of legal rules"; *Thomas v. Washington Gas Light Co.*, 448 U.S.261, 272 (1980).

analytical process was wrong or because the process, though technically legitimate, was somehow imperfectly utilized, and then if either have been established, to *further* demonstrate that any judicial error thus exposed must be done away with by suspending the operation of stare decisis.

II. SECTION 12(2) CLAIMS ARE NOT SUBJECT TO PRE-DISPUTE ARBITRATION AGREEMENTS ABSENT CONGRESSIONAL AMENDMENT

1. *Wilko* Adopted the Correct Analytical Framework For Integrating The Two Federal Statutes Involved In This Case.

The *Wilko* majority opinion has been viewed as having decided that case on the analytical framework set forth in the majority's final paragaraph where the Court wrote as follows:

> Two policies, not easily reconcilable, are involved in this case. Congress has afforded participants in transactions subject to its legislative power an opportunity generally to secure prompt, economical and adequate solution of controversies through arbitration if the parties are willing to accept less certainty of legally correct adjustment. On the other hand, it has enacted the Securities Act to protect the rights of investors and has forbidden a waiver of any of those rights. Recognizing the advantages that prior agreements for arbitration may provide for the solution of commercial controversies, we decide that the intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the Act. [footnote omitted]

Wilko, 346 U.S. at 438.

In *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth*, 473 U.S. 614, 627 (1985) (citing *Wilko*) the Court endorsed the above analytical framework stating that:

> "Just as it is the congressional policy manifested in the Federal Arbitration Act that requires courts liberally to construe the scope of arbitration agreements covered by that Act, it is the congressional

intention expressed in some other statute on which the courts must rely to identify any category of claims as to which agreements to arbitrate will be held unenforceable."

Further, in Shearson/American Express v. McMahon, 482 U.S. ___, 107 S.Ct. 2332, 2338 (1987) the majority opinion, in reference to the 1934 Securities and Exchange Act, 15 U.S.C. § 78a et. seq. (1982) also stated:

> "To defeat application of the Arbitration Act in this case, therefore, the McMahons must demonstrate that Congress intended to make an exception to the Arbitration Act for claims arising under RICO and the Exchange Act, an intention discernible from the text, history, or purposes of the statute."

Under this Wilko framework, a final determination is made as to the Congressional intent of each statute through its "text or legislative history." See *McMahon*, 107 S. Ct. at 2337 (quoting *Mitsubishi* at 628). The requisite analysis and determination have already been made with respect to the arbitrability of 12(2) claims. Since *McMahon* so recently validated the process[2] used in *Wilko*, if 12(2) claims are now to be rendered arbitrable, absent Congressional amendment, such change must be effected through a re-examination of legislative intent.

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[2] In Petitioners' view *Wilko* should be interpreted as a case where this Court *harmonized* two federal statutes. While recent cases have apparently repeated the language of *Wilko*, the fact is that this Court has subtly surrounded such *Wilko* language with a confrontational gloss that casts those resisting arbitration of federal statutory claims in roles of assailants rather than what Petitioners would suggest ought to be roles as beneficiaries of those post-1924 legislative enactments provided for anticipatorily by the 68th Congress when it adopted, in § 2 of the FAA, its savings clause phrase "save upon such grounds as exist at law or in equity . . . " 9 U.S.C. § 2 (1982). The recent confrontational gloss is evidenced by the use of words such as "overriden" (*McMahon*, 107 S. Ct. at 2337) and "exception" (*McMahon* id. at 2338). It is to be noted that the

2. Since *Wilko*'s Analytical Process Has Been Left Intact, Respondent Must Show That The *Wilko* Court Utilized The Process In Such A Manner As Produced An Incorrect View Of Legislative Intent.

McMahon asserts that the *investor* "must demonstrate that Congress intended to make an exception to the Arbitration Act," *McMahon*, 107 S. Ct. at 2338. This alleged burden in the context of the 1933 Securities Act where the strongest possible pro-investor legislative intent was expressed by Congress, is inappropriate. The 73rd Congress rode the crest of a tidal wave of national anger,[3] it was a Congress committed to guaranteeing that the nation would never again be brought to its knees by the corrupt practices of the securities industry. It is critical to recall that the value of securities had fallen by some $50,000,000,000, that so many men's lives had been ruined, that millions of workers had become unemployed, and that capital formation had been drastically reduced. Times were desperate. The legislative response

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Wilko majority utilized the phrase "not easily reconcilable," *Wilko*, 346 U.S. at 438. The choice of "easily" cannot have been fortuitous and suggests that the *Wilko* court did, in fact, reconcile the two acts. Such reconciliation can be achieved by giving the logical interpretation to § 2 of the FAA, namely that if a federal statute such as the 1933 Securities Act makes an arbitration "provision' or "contract," "unenforceable," then it is just that. Rather than there being a frontal assault on the FAA, there is instead the integration of later federal legislative policies *anticipated* by those who drafted § 2 of the FAA. As noted in *Morton v. Mancari*, 417 U.S. 535, 551 (1974), "when two statutes are capable of co-existence, it is the duty of the courts . . . to regard each as effective."

[3] "Out of its despair and anger grew the tenth positive plank of the Democratic National Platform and thereafter the Securities Act of 1933," L. James, *The Securities Act of 1933*, 32 MICH. L. REV. 624, 630 (1934).

was unprecedented. From the enactment of fiduciary[4] standards to the revolutionary adoption of *Caveat Venditor*, the 1933 Securities Act seethed with the highest level of public protection. The legislative history, the text of the Act, contemporary periodical literature, and fifty years of scholarly analysis all vehemently recognize such protective intent. Given the historical context of the 1933 Act one is hard-pressed to imagine that the 73rd Congress *contemplated*, let alone would have ever *approved*, any compromise of investor protection including waiver of § 22(a)'s judicial forum elections – part of what several commentators have called the *in terrorem* civil liability provisions of the Act.[5]

Senate Report 41 berates "high-powered salesmen" and expresses the hope that " . . . this act will provide like advantage and protection for the American investing public and if anyone hereafter shall have the temerity to engage in such nefarious practices as in the past some American security sellers have indulged in, that punishment under this act will be swift and certain. Justice demands that the protection which this legislation will afford to the American people should no longer be delayed." Sen. Rep. No. 41, 73d Cong., 1st Sess. p. 1-2 (1933).

Senate Report 47 further states that one of the legislative goals is "to prevent further exploitation of the public" and " . . . to restore the confidence of the prospective investor . . . " Sen. Rep. No. 47, 73d Cong., 1st Sess. p. 1 (1933). House Report 85 refers to the "cold figures" which "spell tragedy in the lives of thousands of individuals who invested their life savings, accumulated after years

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[4] "To impose a lesser responsibility would nullify the purposes of this legislation." H.R. Rep. No. 85, 73rd Cong., 1st Sess., 10 (1933) Congress was not of a compromising frame of mind.

[5] See W. O. Douglas & G. E. Bates, *The Federal Securities Act of 1933*, 43 YALE L. J. 171, 173 (1933). The authors also note that "In any event it [Act] will require judicial construction to determine damages . . . " [under § 11]. Id. at 178.

of effort, in these worthless securities" and notes that " . . . persons . . . who sponsor the investment of other people's money should be held up to the high standards of trusteeship." H. R. Rep. No. 85, 73d Cong., 1st Sess. p. 3 (1933).

This report goes on to observe that "The character of civil liabilities imposed by this bill are described in detail elsewhere. Their essential characteristic consists of a requirement that all those responsible upon which the public is solicited to invest money shall be held to standards like those imposed by law upon a fiduciary."[6] Id. at 5. The report continues on to state that "Sections 11 and 12 create and define the civil liabilities . . . Fundamentally, these sections *entitle* [emphasis supplied] the buyer of securities . . . to sue for recovery . . . " Id. at 9.

Nor is the record of the debates of both Houses any less pointed. Representative Mapes noted that the United States was "farther behind than any other civilized nation . . . with respect to preserving the rights of the purchasers of securities." 72 Cong. Rec. 2912 (1933).[7] Representative Sabath noted that the securities fraud problem has " . . . closed thousands of banks, that has

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[6] See also H.R. Rep. No. 85, 73d Cong., 1st Sess. (1933) at 21, § 11(a), and id. at 23 § 12.

[7] The 1933 Act drew heavily on the English experience. As Senator Norbeck noted, for example, that the Act prohibited half-truths, an idea "in fact copied after the British law" 72 Cong. Rec. 3223 (1933). There were also other lessons learned from English law which were particularly relevant to § 14. As noted by one writer, "In England before the Companies Act of 1900 the courts honored stipulations that bound the purchasers to waive the statutory liabilities so long as the stipulations were not too 'tricky' [citing *Greenwood v. Leather Shod Wheel Co.*, [1900], 1 Ch. 421 (C.A.) and *Cackett v. Keswick*, [1902], 2 Ch. 456 (C.A.)]. Since the turn of the century, however, this ready means of evasion has been unavailable in England, and here again Congress profited from the English experience." [footnote omitted] L. Loss, *Fundamentals of Securities Regulation*, 1189 (1983). Professor Loss used *Wilko* as the basis for the Model Securities Code's § 1725 pre-dispute arbitration waiver prohibitions.

forced thousands of small merchants into bankruptcy, and that has thrown 15,000,000 people out of employment" [Applause]. Id. at 2915.

In the words of the bill's architect, Representative Rayburn:

> "This catastrophe so colossal as to stagger the imagination did not come upon our people through the machinations of the common fraud. This loss of an amount equa' to perhaps a third of the total national wealth did not follow from the kind of confidence game against which parents warn their sons. It came through the leadership that the average investor had a right to believe he could trust. These securities were peddled among the people by firms like Halsey, Stuart & Co. . . ."

72 Cong. Rec. 2918 (1933).

Representative Chapman stated "Such criminals ought to be held not only to *full* [emphasis supplied] civil responsibility . . . ", and "If there had been such a law, thousands of widows and orphans would not this day be saddened and crushed as the result of having invested their money in worthless securities . . . The enactment of this bill into law will mean the fulfillment of one of the most vital pre-election promises of our great President and will be another forward step in ushering in a brighter and better day for American business and the American public" [Applause]. Id. at 2935.

Representative Cannon of Wisconsin observed " . . . I do not think there is a Member of this House who has come in contact with more unfortunate victims of fraudulent securities . . . than I. I have seen men and women, old and bent with age, suffer the loss of their life savings as the result of purchasing fraudulent worthless stocks . . . " Id. at 2941.

Representative Lambeth referred to "house to house solicitation that the unwary, the unworldly, and the uninformed are chiefly defrauded. We are all familiar with the high-pressure security salesman, his elaborate technique

of approach and of closing, his prepared harangue to outtalk the unprepared prospect, and his faked-up enthusiasm." Id. at 2949.

Representative Reilly stated that "The real test of the efficacy of this legislative proposal is to be determined by the relentless vigor with which it proposes that the defrauded purchaser may pursue properly responsible parties."[8] Id. at 2952.

Representative Beedy, in reference to prospectus format, noted that the bill would compel the publishing of prospectuses "in sizable type, and not print in some inconspicuous place and in small type statements equally material." Id. at 2953.

In the Senate the story was the same. Senator Fletcher stated: "The purpose of the bill is to protect the investing public . . . to prevent further exploitation of the public . . . to restore the confidence of the prospective investor." Id. at 2983. Senator Johnson echoed House sentiment that investors were vulnerable to " . . . high-powered salesmanship." Id. at 2988.

In summary, the entire legislative history of the 1933 Act clearly shows that Congress accepted the Brandeis thesis of fiduciary obligation, recognized the need to restore investor confidence, pointedly and repeatedly referred to the need to protect the old and unsophisticated, commented on high-pressure sales realities and assailed the "fine print" tactics of the industry. The word "sue" punctuates the entire legislative history.

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[8] And as Dean Landis, who was instrumental in preparing the legislation stated, "We were particularly anxious through the imposition of adequate civil penalties to assure the performance by corporate directors and officers of their fiduciary obligations . . . " J. Landis, *The Legislative History of the Securities Act of 1953*, 28 GEO. WASH. L.REV. 29, 35 (1959/60).

3. Any Re-examination Of The FAA Will Reveal That Such Statute's Goals Were Less Ambitious Than Recent Court Decisions Suggest And Were Perceived To Be Of Less National Significance Than Those Of The 1933 Action.

The legislative history of the United States Arbitration Act, 9 U.S.C. § 1 et. seq. (1982), is rather less instructive as to its goals.[9] Perhaps the most telling comment came in the Senate where Senator Walsh acknowledged that "The business interests of the country find so much delay attending the trial of lawsuits in courts that there is a very general demand for a revision of the law in this regard." 66 Cong. Rec. 984 (1924). Further, the apparent level of comprehension of the literal text of such legislative proposal (at least viewed from the perspective of 64 years of judicial construction) is shown by the Senator's later explanation that the bill meant " . . . that whenever parties agree in their contracts to submit controversies arising under the contracts to arbitration, and then either one refuses to carry out that agreement by appointing an arbitrator, as is provided in the provision for arbitration, the other party may institute his suit in court and recite the facts in relation to the agreement and the refusal upon the part of the other party to appoint an arbitrator- . . . whereupon the court will appoint an arbitrator and the arbitration will proceed."[10] Id. at 984.

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[9] In *Southland Corp. v. Keating*, 465 U.S. 1, 25 (1984), Justice O'Connor asserted that "One rarely finds a legislative history as unambiguous as the FAA's." On the other hand the majority in that same case acknowledged that " . . . the legislative history is not without ambiguities." Id. at 12.

[10] Such an explanation is more in line with the commercial arbitration practices of that era. Those practices were very different from the nature of arbitration of customer fraud claims under the facts presented in Petitioners' cases. What Senator Walsh does unquestionably accurately reveal is that it was *business interests*, not consumers, who were behind the 1924 FAA.

The House Report of the Federal Arbitration Act consists of some 71 lines of text and evidences no intent to do anything but place arbitration agreements "upon the same footing as other contracts . . . " H. Rep. 96, 68th Cong., 1st Sess. at 1 (1924). The report notes that there was an " . . . entire lack of opposition before the committee . . . " Id. at 2.

The Senate Report, Sen. Rep. No. 536, 68th Cong. 1st Sess. (1924), is somewhat longer than its House counterpart,[11] but while it attempts a brief explanation of each of the bill's provisions, no attempt is made to explain § 2 which is surely one of the most significant and enigmatic phrases in the act, namely " . . . save upon such grounds as exist at law or equity for the revocation of any contract." 9 U.S.C. § 2 (1982). The Senate Report, id. at 3, additionally reveals that the Arbitration Society of America was involved in the bill's passage.[12] There is nothing in the Senate Report which suggests any kind of an *elevated* federal policy.[13]

In reality the Federal Arbitration Act duplicated the key provisions of the New York Arbitration Act which

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[11] There was essentially no debate in either House.

[12] The Act was also endorsed by the American Bar Association, although the FAA provisions conflicted with the ABA's Commission on Uniform Legislation endorsement of only *existing* dispute enforceability (as per the Uniform Act). See S. Jones, *Historical Development of Commercial Arbitration in the United States*, 12 MINN. L. REV. 240, 249, n. 45 (1928).

[13] "Some courts, to be sure, have discerned 'a strong federal policy in favor of [commercial] arbitration' over litigation. This policy they say, arises to 'help ease the current congestion of court calendars.' But the authorities relied upon by these courts reveal no such policy." [footnotes omitted] Notes, *Incorporation of State Law Under the Federal Arbitration Act*, 78 MICH. L. REV. 1391, 1403 (1980). In truth the "same-footing" catchphrase suggests something very different from an "elevated policy."

had been passed five years beforehand.[14] Recognizing that consumerism was in its infancy and that the spirit of laissez faire was not finally exorcised until the demise of substantive due process, it is fair to surmise that what Congress had in mind in 1924 was the validation of the enforceability of the historically familiar fields of commercial arbitration, insurance, maritime, and multinational,[15] with no intent to burden future federal policies expressed in legislative form.[16]

Considering the text and legislative history of both the Federal Arbitration Act and the 1933 Securities Act, it is difficult to fairly view Congressional intent in any fashion but as precluding the enforcement of pre-dispute, public customer[17] form contracts with arbitration terms buried in the fine print. As shown, the legislative history of the 1933 Act addresses in some fashion, each such parameter.

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[14] See, for example, T. Stipanowich, *Rethinking American Arbitration*, 63 IND. L.J. 425, 426 n. 2 (1988) "Extensive lobbying efforts secured . . . legislation modeled on New York's act."

[15] See H. Cohen & K. Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265 at 265 (1926). ". . . the reform is directed primarily toward settlement of commercial disputes." The authors further noted that "Not all questions arising out of contracts ought to be arbitrated. It is a remedy peculiarly suited to the disposition of the ordinary disputes between merchants as to questions of facts – quantity, quality, time of delivery . . . It is not the proper method for deciding points of law of major importance involving constitutional questions or policy in the application of statutes . . . " Id. at 281.

[16] Nor to critically damage state consumer protection law which is the practical result of the interpreted breadth of the Commerce Clause.

[17] Especially the unsophisticated investor. Generally, see C. Fletcher, *Privatizing Securities Disputes Through the Enforcement of Arbitration Agreements*, 71 MINN L. REV. 393 at 427 (1987) "THE SOPHISTICATED INVESTOR EXCEPTION – ITS TIME HAS COME."

4. Post-enactment Conduct Demonstrates The Congressional View Of The Preeminence Of The 1933 Act.

Again, as noted elsewhere, in 1975 Congress specifically endorsed *Wilko* and its non-arbitrability *ratio*.[18] While Petitioners are not persuaded by the majority's opinion in *McMahon* that the legislative reference in question was not an endorsement of the non-arbitrability of § 10(b) claims under the 1934 Exchange Act, 107 S. Ct. at 2343, that worst-case Exchange Act hypothesis cannot be transformed into a legislative disapproval of *Wilko* per se.[19]

To all of the above must be added the observation that Congress has been in the process of legislatively addressing *McMahon* and the fact that no parallel legislative proposals have yet been suggested with respect to

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[18] As this Court noted in *Herman & MacLean v. Huddleston*, 459 U.S. 375, 384-5 (1983), "This cumulative construction of the remedies under the 1933 and 1934 Acts is also supported by the fact that, when Congress comprehensively revised the securities law in 1975, a consistent line of judicial decisions had permitted plaintiffs to sue under § 10(b) regardless of the availability of express remedies. In 1975 Congress enacted the 'most substantial and significant revision of this country's Federal securities *laws* [emphasis supplied] since the passage of the Securities Exchange Act in 1934.' See Securities Acts Amendments of 1975, Pub. L. 94-29, 89 Stat. 97 . . . In light of this well-established judicial interpretation to leave § 10(b) intact suggests that Congress ratified the cumulative nature of the § 10(b) action."

[19] Petitioners note here that while the *Wilko* comment was made in the context of amendments to the 1934 Exchange Act, certainly had Congress any desire to legislatively disagree with *Wilko*, it would have been a relatively simple matter to include an appropriate amendment to the 1933 Act. One will recall that amendments to the 1933 Act were contained in the 1934 legislation itself in Title II.

the *1933 Act* carries with it the inference that *Wilko* is still viewed by Congress as having been correctly decided.[20]

As a matter of clear legislative intent, therefore, § 12(2) claims may not be subjected to compulsory arbitration.

III. THE QUALITY OF ARBITRATION IS NOT RELEVANT TO *WILKO* BECAUSE THE 1933 ACT'S GOALS ARE INCONSISTENT WITH ALL PRE-DISPUTE COMPULSORY ARBITRATION AGREEMENTS

1. Any Focus On The Quality Of Arbitration Is Inappropriate With Respect To The 1933 Act.

Given the observable recent pro-arbitration stance of this Court, which can most clearly be seen beginning with *Scherk v. Alberto-Culver Co.*, 417 U.S. 506 (1974), it is difficult not to view *McMahon*, as many commentators already have, as the staging ground for an assault on *Wilko*.[21] The legitimacy of such assault is jurisprudentially as well as politically questionable.[22]

As Petitioners have argued elsewhere, *Wilko* clearly held that arbitration was *inherently* antithetical to the

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[20] Although H.R. 4960 died last year, it is likely to be reintroduced.

[21] See, Note, *The Arbitrability of Federal Securities Claims: Wilko's Swan Song*, 42 U. MIAMI L. REV. 203, 228 (1987).

[22] Petitioners believe that *McMahon* was wrongly decided and that, but for those principles of stare decisis set forth by Petitioners elsewhere in support of the preservation of the *Wilko* precedent, they would otherwise advocate that *McMahon* be overruled. The only arguably credible justification for the *McMahon* opinion, in Petitioners' view, is that the Exchange Act lacked the multiple forums found in the 1933 Act as many commentators have noted. According to one, "[In *Wilko*] The Supreme Court emphasized that SA § 22(a) (conferring jurisdiction over suits to the courts) could not be waived because it gave the aggrieved person the right to select the judicial forum." See A. Bromberg & L. Lowenfels, 2 *Securities Fraud and Commodities Fraud*, § 5:128 (1988).

legislative mandate of the 1933 Securities Act. That reality, variously verbalized by legal commentators and courts over the past thirty-five years, was, as noted, also utilized by this Court in distinguishing *Wilko* in all of the relevant cases preceding *McMahon* and no matter how skillful an attack is launched from the haze[23] of *McMahon*, *Wilko* cannot, in logical terms, be circumvented without significant institutional loss.

No matter how desirable a destruction of *Wilko* may appear from the perspective of a reduction of the federal docket,[24] the word "arbitration" in *Wilko* should not be

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[23] "The Court was intentionally sending a mixed signal, so that its discussion of *Wilko* would not be misunderstood as a decision on a matter not squarely before the Court. That mixed signal indicates that although the Court was willing to disparage *Wilko* as without foundation under contemporary circumstances, it was unwilling to give a hint as to how it might decode that case . . . today." C. Fletcher, *Learning to Live With the Federal Arbitration Act - Securities Litigation on a Post-McMahon World*, 37 EMORY L.J. 99, 114 (1988).

[24] One writer has observed, "As we reflect, above all we must remember that the overarching goal of alternative dispute resolution is to provide equal justice for all." 'If . . . reform benefits only judges, then it isn't worth pursuing . . . ' H. Edwards, *Alternative Dispute Resolution: Panacea or Anathema?*, 99 HARV. L. REV. 668, 684 (1986) (Citing Higginbotham, *The Priority of Human Rights in Court Reform*). Another commentator has noted that "Given repeated assertions regarding the near crisis state of the overloaded judicial system, one might think that the intent behind the Arbitration Act was to override judicial enforcement of all legal claims except those whose removal from the courts might prompt an even more immediate crisis in the country's institutional structure." E. Morgan, *Contract Theory and the Sources of Rights: An Approach to the Arbitrability Question*, 60 S. CAL. L. REV. 1059, 1068-9 (1987).

given a 1989 footnote explaining that the contemporaneous *quality* of arbitration was really the fatal flaw detected in *Wilko*. It was not.[25]

It is to be further observed that a good argument can be made that the *Wilko* court would, on the facts now before this Court, have voted *unanimously* to declare these Petitioners' claims non-arbitrable in the context of this pre-dispute form contract. That argument can be made because the two *Wilko* dissenters specifically stated that their view of arbitrability would be different if Plaintiff "in opening an account had no choice but to accept the arbitration stipulation, thereby making the stipulation an unconscionable and unenforceable provision . . ."[26] 346 U.S. at 440.

While it would otherwise be appropriate to argue here that § 10(b) claims are distinguishable from § 12(2) claims (and that therefore whatever *McMahon*[27] held that it is not a holding that conflicts with *Wilko*), that argument in effect has already been presented most skillfully

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[25] The *McMahon* majority opinion fails to effectively address the problem of the variable quality of arbitration. While there is some suggestion in *McMahon* that perhaps arbitration of § 10(b) claims is acceptable so long as that arbitration is subject to the scrutiny of the SEC, the irony is that investors would be, on the evidence thus far presented by the AAA and SIA, apparently statistically better off in an AAA proceeding.

[26] Lack of choice is now the case with *this* type of account. See *infra* at 46 n. 98.

[27] The following are some of the critical scholarly comments relevant to the view of arbitrability of 10(b) claims and/or of *McMahon* per se: "A careful reading of *Wilko*, coupled with a thorough analysis of the relevant provisions of the two securities acts, requires that the *Wilko* doctrine be extended to section 10(b) claims.", Comments, *Predispute Arbitration Agreements Between Brokers and Investors; The Extension of Wilko to § 10(b) Claims*, 46 MD. L. REV. 339, 377 (1987); "What is more difficult

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to understand is why in *Shearson/American Express v. McMahon*, the Court held that predispute arbitration clauses should be enforceable in spite of statutory mandates and the ramifications of the decision . . . Since 1982 there have been at least 10 million new investors . . . and a 128% increase in complaints against brokers filed with the SEC, a total of 15,750 complaints in 1986. The market crash of October 19, 1987 spawned scores of disputes . . . Thus the mandatory enforcement of predispute arbitration agreements will have a significant impact on investors' efforts to recover . . . " [footnotes omitted], P. Shub, *Shearson/American Express v. McMahon: The Expanding Scope of Securities Arbitration*, 12 NOVA L. REV. 1375, 1378-9 (1988); "In response to the Supreme Court's recent endorsement of the arbitral process, Congress must now take measures to assure that, in the steady move towards arbitrability investors' rights are not being unduly compromised." Notes and Comments, *Enforceability of Predispute Arbitration Agreements Under the Federal Securities Laws: Shearson/American Express vs. McMahon*, 8 PACE L. REV. 193, 235 (1988); "The problem with the *McMahon* opinion is the Court's misreading of the *Wilko* decision.", Note, *Securities-Arbitration-Agreements to Arbitrate Are Valid*, 10 U. ARK. LITTLE ROCK L.J. 523, 532 (1987-88); "Rather than following these cases [*Byrd*, and *Mitsubishi*] the Supreme Court should re-examine its still valid reasoning in *Wilko*.", H. Sanchez, *Should Claims Involving Public Customers Arising Under the Securities Exchange Act of 1934 Be Subject to Compulsory Arbitration?*, 10 HARV. J. LAW & PUB. POLICY 173, 187 (1986); "The note concludes that the *McMahon* Court reached the wrong result by giving an unprecedented interpretation to the Exchange Act, by reading *Wilko* too narrowly, and by ignoring policy problems inherent in the arbitration of securities disputes.", Note, *Who's Protecting the Investors? Shearson/American Express v. McMahon*, 19 ARIZ L. J. 793, 794 (1987) (The Note also observes that " . . . the concerns about the suitability of arbitration apply with perhaps greater force today than in 1953 when *Wilko* was decided." Id. at 812); " . . . *McMahon* . . . held that brokerage houses may include arbitration provisions within client agreements. Unfortunately the *McMahon* Court simply condoned section 10(b) arbitration without considering

by Respondent to this Court[28] and to the Fifth Circuit[29] where Respondent argued that *Wilko* was clearly distinguishable because of 1933/1934 Act differences. Hopefully this Court, will not be swayed by what Petitioners now anticipate will be a change of heart by Respondent.

2. A Basic Analysis Of The Circumstances Surrounding These Petitioners' Cases, Shows That Compulsory Arbitration of Petitioners' Claims Is Antithetical To The Undisputed Goals Of The 1933 Act.

A. First Level Arbitration Analysis

Notwithstanding those insightful admonitions frequently made concerning the limitations of common sense, Petitioners believe that certain common sense, general observations should be made about arbitration of Petitioners' claims under the 1933 Act.

First, the very fact that the specific arbitration language appears in a form document prepared by industry lawyers, at least *suggests* that Respondent put the arbitration term in such form document for some purpose that was deemed by Respondent to be beneficial to Respondent. Respondent's posture is, of course, that the reason for the utilization of the clause is that arbitration saves time and money. The further argument is then advanced that such benefits are mutual and hence fair. Before examining the substance of such argument, it is useful to look first at the specific document context in which the

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the possible repercussions of its *en mass* implementation.", comments, *A Statutory Proposal to Determine Arbitral Forums For 10(b) Disputes*, 28 SANTA CLARA L. REV. 389, 415-16 (1988).

[28] Brief of Petitioners, *Shearson/American Express v. McMahon*, No. 86-44, at 16-32.

[29] "Claims under the Securities Exchange Act of 1934 are arbitrable, whereas those under the Securities Act of 1933 are not, precisely due to the differences in those Acts . . . " Reply Brief of Appellant Shearson/American Express, *Mayaja v. Bodkin*, No. 85-2762 (5th Cir. 1985) p. 4.

arbitration term was found. This particular arbitration clause was buried in fine print, in the last paragraph of the first side of a two-sided document. The particular paragraph[30] not only begins with an obscure reference to "successors," it is also preceded by a dozen other fine-print paragraphs which would challenge the intellect and attention span of the proverbial Philadelphia lawyer.

Further, this particular arbitration paragraph contains an *election-of-law* provision so that the investor has apparently agreed that Texas law will not apply. Not only may that be perceived as objectionable per se, it is all the more so when one observes that in order to do business in Texas (as is true in most states), brokers are compelled by their Uniform Securities and Commodities Applications to promise, in writing, to the Texas Securities Commission, to abide by all the laws of Texas.

The sworn verification portion of that U4 application, for example, reads as follows:

> "2. To induce the agency, *jurisdiction* or organization with or to which I am filing or submitting this application to receive and consider it:
>
> C. I agree to abide by the *Statute(s)*, Constitution(s), Rules and By-Laws as *any* of the foregoing are amended from time to time of the agency, *jurisdiction* or organization with or to which I am filing or submitting this application." [emphasis supplied]

Further, and even more specifically, Paragraph 5 of the U4 verification provides as follows:

> "5 . . . *and I do hereby consent that any such action or proceeding against me may be commenced in any court*

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[30] The paragraph read as follows: "This agreement shall inure to the benefit of your successors and assigns, shall be binding on the undersigned, my heirs, executors, administrators and assigns, and shall be governed by the laws of the State of New York. Unless unenforceable due to federal or state law, . . . "

of competent jurisdiction and proper venue within said State . . . "[31] [emphasis supplied]

Notwithstanding the above, Respondent's arbitration paragraph not only attempted to limit the arbitration forum to the NYSE and NASD (a limitation which should also be perceived as per se objectionable) this form paragraph also required that the customer elect between the pre-chosen two forums *within five days*. That period of time is unconscionably short.[32]

The next common-sense observation to be made is that regardless of whatever level of supervision of the Securities & Exchange Commission is imposed,[33] the customer has, in effect, agreed to have his case brought

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[31] It is to be noted that this paragraph refers to *any* action in *any* court.

[32] Since the investor, regardless of his level of sophistication, is unlikely to have been previously involved in any type of arbitration proceeding, it is obvious that he will have no information upon which to make such an election but would surely sense that such an election is important and would surely believe that a five day deadline is unfair. That period of time is, for example, 15 days less than time allowed for answering a federal court complaint. While the focus here is the *perception* of this time-constraint, Petitioners would also be very interested in viewing this Respondent's 1988 case files to see 1) how many times has Shearson/American Express been able to itself make the forum election because the five-day deadline was not met by the investor, and 2) when Respondent makes such default elections, whether or not such elections have been divided evenly between the NASD and NYSE. Petitioners suspect first that it is in fact Respondent who makes the majority of forum elections, and second that as an indication of Respondent's knowledge or belief that one or the other forum is most advantageous to this Respondent, that such case files would reveal that Respondent chooses particular forums in particular parts of the country.

[33] Which in Petitioners' view has never been very significant as the non-enforcement of Rule 15c2-2 has shown. See also, Ingersoll, *Sleepy Watchdogs*, WALL ST. J., July 21, 1987 at 1, col. 6.

before a division the brokerage house's peers.[34] Given the obvious inequality in power between Respondent and any of these investors, it is not unreasonable to assume that such investor would be at a significant disadvantage *in any forum*, however, winning contests on the opponent's home court is difficult even where combatants are evenly matched.

Third, the direct inherent economic self-interest of the forums themselves must be recognized. Officials of the arbitration divisions of the NYSE and NASD have dependents to support. So do the arbitrators themselves. Without arbitration, there is no employment. Why do the NYSE and NASD get to decide public customer securities fraud cases? Is it because the *investor* has selected both as options? Hardly. The NYSE and NASD hear these cases *because it is brokerage houses like Shearson/American Express who select such entities as arbitration forums by printing those forums' names in the form document* in the first place. Can it be seriously doubted what would happen if these "unbiased" arbitration proceedings produced frequent and large awards against the party that gets to specify what arbitration forums can be utilized? It is for that very reason that such arbitration, as presented in this type of securities fraud case, is *intrinsically and irreparably* unfair to investors. That unfairness is even further amplified when this financial self-interest is solidified by the arbitration forum as an *official* policy carried out through the exchange's manipulation of the composition of arbitration panels as is now the case.

Beyond these most obvious, inherent common-sense realities lurk a plethora of serious constitutional law issues. While it is true that most constitutional objections have already been individually dispatched,[35] the sheer

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[34] As noted by one commentator, "SRO's are funded by and most closely involved with their members." S. Miller, *Self-Regulation of the Securities Markets: A Critical Examination*, 42 WASH. & LEE. L. REV. 883, 884 (1985).

[35] See, for example, *Thomas v. Union Carbide Agricultural Products Co., et al*, 473 U.S. 568 (1985) with respect to Art. III issues.

number and weight of all of these constitutional issues is deeply troubling. Taken together, the issues of Article III judges,[36] waiver of jury,[37] due process and pre-emption of state law, are truly disturbing.[38]

Further, if arbitration is such an outstanding, *mutually* advantageous forum choice, why does the securities industry need to have *pre*-dispute arbitration terms? Surely if there is a mutuality of advantage the market will, via *post*-dispute agreements negotiated by the parties, make such *pre*-dispute agreements unnecessary. Presumably even the most skeptical, misguided litigant or attorney will eventually see the light. The simple truth, however, is that Respondent and the Securities Industry see enormous *unilateral* advantage in *this* form of arbitration, much of which would be lost by a *bargained-for* arbitration format where defrauded customers could negotiate rules, remedies, and arbitration personnel.[39]

Accordingly, whatever the alleged level of mutuality or quality of arbitration, a common sense, thoughtful

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[36] The framers considered it critically important that federal judges be given the highest level of independence. The nature of fraud relevant to these Petitioners gives cause for concern that *all* of that level of decisional independence is required for these Petitioners.

[37] Would it not be reasonable, for example, to require at least a knowing/intelligent waiver of the right to a jury trial? See, for example, *Hodges v. Easton*, 106 U.S. 408, 412 (1882) " . . . every reasonable presumption should be indulged against its [jury] waiver." Petitioners would suggest that in the overall scheme of things, that the Seventh Amendment is deserving of a better fate than effective repeal by an ill-considered 1924 enactment interpreted in such a fashion as to raise public concern as to judicial motive.

[38] They suggest an argument for an arithmetic constitutional rights violation theory somewhat in the reverse nature of principles seen in one-man/one-vote multi-districting doctrinology.

[39] Perhaps a fairly bargained-for arbitration *was* the intent of the FAA. See Senator Walsh's FAA comments, *supra* p. 12.

review of these relevant customer contracts would surely and reasonably create at least the strongest *suspicion* that there is a significant unilateral benefit to the brokerage-house. That suspicion is not diminished by the further realization that the brokerage house will rarely be a *plaintiff* in a customer dispute.

In *any* context, all of the above considerations would indeed be weighty, but in the context of the fiduciary standard[40] imposed by the 1933 Act upon those entrusted with "other people's money,"[41] that such pre-dispute arbitration clauses are given *any* legitimacy, is somewhat remarkable.[42] Perhaps the greatest of life's tragedies is that ultimately we profit so little from the lessons of history.

All of the above first-level investor perceptions clearly constitute a conflict with the patent, oft-repeated goal of the 1933 Act *to create confidence in the stock market*

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[40] Aside from the unenforceability intent issues of the 1933 Act, it is to be noted that § 173, *Restatement (Second) Of Contracts*, (1982) would render certain contracts with fiduciaries voidable. Those fiduciary principles are germane here.

[41] "There was a restatement of the earlier creed of Brandeis that members of the financial oligarchy handling other people's money are trustees." W. O. Douglas, *Foreward, The Legislative History of the Securities Act*, 28 GEO. WASH. L. REV. 1, at 1 (1959). See also, H. Rep. 85, 73d Cong., 1st Sess. at p. 3 (" . . . should be held up to the high standards of trusteeship."); ("The character of civil liabilities imposed by this bill . . . consists of a requirement that all those responsible for statements upon the face of which the public is solicited to invest . . . shall be held to standards like those imposed by law upon a fiduciary."). id at 5.

[42] States like Massachusetts have also recently attempted to respond to *McMahon* (see 950 CMR 12.204 (a)(2)(G) (1988)), however pre-emption is probably an insurmountable impediment in light of *Keating*.

so as to revitalize capital formation,[43] and cannot be negated by any improvement of arbitration per se since these first level problems are, more than anything, problems of *context*.

B. Second Level Arbitration Analysis

The second level of Petitioners' arbitration analysis focuses on the intent[44] of Respondent as is logically deducible from a less-easily perceived arbitration attribute extant at the time these form documents were presented to Petitioners and such attribute's resultant impact on the legislative goals of the 1933 Act.

That Texas residents – or the residents of the other forty-eight states – would be required to agree that the law of *New York* would apply, raises some immediate substantive suspicion.[45] Petitioners limit their analysis here to a single characteristic of arbitration then extant under New York law, namely the unavailability punitive

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[43] "It may be argued that whether or not the arbitration agreement was imposed on an unknowing investor, the investor is just as well off, if not better, in arbitration. Whether or not this is true, the critical consideration in the markets of capital accumulation has always been the public perception of the market. Even if the buyer is just as well off financially in arbitration, if he thinks he was misled in being forced to arbitrate he may lose confidence in the industry and refuse to invest further. This would clearly be detrimental to our economy as a whole." J. D. Fiore, *Problems In Alternative Dispute Resolution: Arbitration Agreements As Contracts of Adhesion in Consumer Securities Disputes*, 93 COM. L. J. 259, 277 (1988).

[44] The fact that these first-time investors, possessing conservative investment objectives, were immediately required to sign a *margin* agreement is an excellent frame of reference from which to begin an analysis of Respondent's probable intent.

[45] As noted by one commentator, the historical choice of law manipulation practiced by the industry was a fundamental evil the 1933 Act sought to eradicate through the creation of federal

damages. At the time the relevant documents were presented to Petitioners, Respondent knew that punitive damages had not been historically awarded in New York arbitration.[46]

If arbitration is indeed a "forum neutral"[47] election then one would expect that there would be a remedial neutrality. That is not the case. One has merely to ask the following question: On how many occasions since the initiation of broker-customer relationships, has a brokerage house recovered *or even sought*, punitive damages either in litigation or arbitration as against a public customer?

Accordingly, this second level analysis reveals a serious conflict with the both primary goals of the 1933

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substantive law. See G. Feldman, *The New Federal Securities Act*, 14 B.U.L. REV. 1, 2 (1934), "clauses providing that the contract was to take effect 'only upon acceptance at our home office,' fell neatly within the categories of conflict of laws doctrine . . . And the courts have been reluctant to depart from established doctrine even in cases where it had obviously been used merely as a subterfuge to avoid the securities legislation of the investor's residence . . . The call for a remedy for this situation became more pressing with the sharpened insight resulting from a badly shaken securities market. A new administration brought an immediate response to the public clamor. That response was the new Federal Securities Act." [footnote omitted]

[46] *Garrity v. Lyle Stuart, Inc.*, 40 N.Y. 2d 354, 386 N.Y.S. 2d 831, 353 N.E. 2d 793 (N.Y. 1976). Despite the frequent statements of subsequent supervision of securities arbitration proceedings by courts, the conventional jurisprudence surrounding the FAA, the overwhelming weight of scholarly analysis, give little cause for optimism.

[47] The entire substance/procedure premise in *McMahon* is difficult to square with *Bernhardt v. Polygraphic Co.*, 350 U.S. 198, 203 (1956) where the Court wrote that " . . . the remedy by arbitration . . . substantially affects the cause of action . . . "

Act – the unprecedented *substantive* protection of the investor *and* the restoration of investor confidence in the market. The extant quality of arbitration alleged does not negate these second-level conflicts with the 1933 Act's goals, nor would any later alleged improvement retroactively cure an investor's perception that an attempt had been made to take advantage of such investor originally.

C. Third Level Arbitration Analysis

Petitioners' third level analysis focuses on Respondent's representation that arbitration is procedurally less expensive and less time-consuming (insofar as those representations are relevant to Petitioners' securities complaints).

The expense of processing civil complaints has three major components – administrative fees, attorneys fees, and witness costs. Since Petitioners, if successful in litigation, would likely recover attorneys fees under as many as four independent state law theories, what is immediately known is that arbitration is likely to make securities complaints less expensive *for the brokerage house* since attorney's fees have not traditionally been awarded in arbitration. The brokerage house will be relieved of paying all *Plaintiffs'* attorneys fees.[48] Even if industry contracts contained a provision that *prevailing* parties in a securities dispute would be awarded attorneys fees, and even *if* one accepts uncritically those arbitration statistics

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[48] See Art. 75, CPLR (Arbitration) § 7513 (N.Y.) for Petitioners' election concerning attorneys fees. With respect to attorney's fees, the following question would surely also be relevant: Why are attorneys fees historically awarded to successful commercial litigation plaintiffs and why has virtually every modern consumer protection statute provided attorneys fees for prevailing consumers? As one writer has noted, "Before UDAP [consumer deceptive trade practices statutes] were enacted, consumers with meritorious complaints were often discouraged from bringing actions because their potential recovery might not justify the cost of litigation. Many UDAL statutes

presented in the Brief of the Securities Industry Association in Support of Certiorari herein,[49] the most recent (1987) data appears to reveal that more than 50%[50] of public customers recovered awards. Accordingly, by omission of an attorneys fee provision in the form contract, and by the otherwise non-availability of attorneys fees in arbitration, the industry's own figures suggest a net economic benefit to industry members.

Since the conventional court system is a subsidized system,[51] it is not surprising to find that usual court

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addressed this problem by providing attorneys fees, and minimum, multiple or punitive damages. The attorneys fees generally reimburse successful plaintiffs [footnote omitted]. Notes, *Resolving the Conflict Between Arbitration Clauses and Claims Under Unfair and Deceptive Practices Act*, 64 B.U.L. REV. 377, 384-85 (1984). Texas law is typical. Tex. Bus. & Com. Code, § 17.50(d) (The Texas Deceptive Trade Practices Act), and Tex. Civ. Rem. & Prac. Code, (§ 38.001(8)) provide for attorney's fees in most consumer contexts. The answer is, of course, to make it economically feasible for the consumer to have the necessary competent legal representation. Without that legal representation the consumer is hopelessly overmatched. Shearson/American Express will never want for the best available legal representation, nor, if the history of the Brownsville office is at all instructive, will Respondent lack good first-hand experience in handling securities fraud claims.

[49] Amicus Curiae Brief, Securities Industry Association, *Rodriguez v. Shearson/American Express*, No. 88-385, Appendix A.

[50] 635 out of 1,146 cases were supposedly decided "in favor" of the public in relevant self-regulatory organizations. Id. at A-3. The fact is that because of the lack of records in arbitration and because of one-line awards, there is an "information vacuum." Once again investors are being asked to trust the industry. These Petitioners respectfully decline. As noted by Respondents in *McMahon*, AAA and SIA statistics are, in any case, misleading. See Brief of Respondents, *Shearson/American Express v. McMahon*, No. 86-44 at 28, n. 22.

[51] Which in and of itself is a reflection of the perception of justice as a societal responsibility.

administrative costs are not overly significant. For complaints of Petitioners' nature, filing and service costs would not normally exceed $200.00 whereas arbitration filing costs relevant to such complaints would typically be $750.00.[52]

Witness costs[53] relevant to Petitioners' claims demonstrate that arbitration is considerably *more expensive* for Petitioners. For example, Respondent, prior to the original appeal in this case, had filed an arbitration application which was scheduled to be heard in Dallas. Such venue would require that somewhere in the neighborhood of forty of Petitioners' witnesses would be required to travel to Dallas. Such expense cannot be deemed an expense "advantage" to Petitioners who otherwise would litigate in Brownsville where most witnesses live and where the fraud occurred.[54]

With respect to allegations of expenditure of *time*, an immediate distinction must be made between the expenditure of time in the process of resolution (which Petitioners would suggest is an expenditure correlating well with the quality of justice dispensed) as opposed to the

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[52] The NASD/NYSE range for these types of fraud claims is from $500.00 to $750.00. See, for example, Sec. 43, NASD Manual-Code of Arbitration Procedure, reprinted by Commerce Clearing House, Washington, D.C. (1985).

[53] Petitioners would suggest that *expert* witness costs would not be significantly venue-dependent on these particular facts.

[54] Venue is, of course, a problem. For an enlightening discussion of venue and securities fraud, see, Comments: *A Statutory Proposal to Determine Arbitral Forums For 10(b) Disputes*, 28 SANTA CLARA L. REV. 389, 391 (1988). As noted there, ". . . *McMahon* gives brokers the opportunity to take advantage of investors because it fails to address the key issue of venue." For a discussion of "cross-country" arbitration and the consumer, see Notes, *Incorporation of State Law Under the Federal Arbitration Act*, 78 MICH. L. REV. 1391, 1412 (1980).

length of time which is like to pass between the *filing of the complaint and a decision or award*. It is this latter category of time-expense which the securities industry apparently advances as a mutual benefit[55] since the industry statistics are structured to make such an argument by showing a rapid turnover of cases. Since the industry is an industry of institutions, with infinite lives, whereas public customers like Petitioners have finite existences, it seems reasonable to conclude that the time of case turnover would be most relevant to *Petitioners*.

Accordingly Petitioners' third level arbitration analysis suggests that if attorneys fees are not awarded, that Respondent and industry members escape paying attorneys fees normally awarded in commercial litigation to prevailing parties, that it is only investors who lose punitive damages, that arbitration *creates* significant venue costs relative to witnesses, that from Petitioners' viewpoint arbitration has no significant impact on administrative costs, and that arbitration has no discernibly *significant* time advantage.[56] Such third level analysis suggests conflicts with the 1933 Act's overall goals of providing an unprecedented level of investor protection and of safeguarding the national economy

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[55] "Arbitration also offers an expeditious result." Amicus Curiae Brief of the Securities Industry Association in Favor of Certiorari, *Rodriguez v. Shearson/American Express*, No. 88-385, at 12.

[56] If every securities complaint becomes subject to compulsory arbitration, or if arbitration's currently suggested reforms are enacted (to expand, for example, discovery) the complaint turnover rate promises to be significantly depreciated. Nor is there necessarily a direct cost nexus to turnover rate. Those other cases related to Petitioners' cases owing to the Southern District of Texas drug and immigration docket, have been sitting for several years in such court without additional costs accruing.

through stimulation of investor confidence, neither of which goals are aided by existing securities arbitration in an adhesive, fiduciary, pre-dispute format.[57]

D. Fourth Level Arbitration Analysis

Petitioners' fourth level analysis focuses on the quality of arbitral *outcome*, which, as is true with prior level analyses, is not only apparently relevant to this Court's view of arbitration expressed in *McMahon*, but also to the Court's anticipated view of the 1933 Securities Act.

As has been recently observed, there has been in "first-wave" alternative dispute resolution, a proclivity for ignoring larger jurisprudential issues.

> "Specifically, while lauding the *quality of its results*, the First Wave ADR movement appears to desire a reduction of the *quantity* of traditional litigation by "focusing" or restricting dispute solutions to the narrowest and most simple results. In the process, the beneficial "public" impact of dispute resolution may be lost and the guidance function of substantive legal norms may be ignored. Similarly, while ADR presents an innovative shift in the procedure of dispute resolution, few ADR proponents have dug deeply into the process oriented "instrumentalist" jurisprudence represented in the writings of Fuller and others. Surprisingly, few jurisprudence and legal philosophy scholars have joined the debate between the First and Second Wave factions, learning the dialectic

[57] It is instructive to note here that in 1933 Representative Black, after refering to civil remedies in the proposed 1933 Act observed that criminal sanctions had never been historically effective. Black posed the rhetorical question "Why do we need this law? We need this law because of the nonenforcement of all present statutes . . . against larceny." See 72 Cong. Rec. 2953 (1933). The Act's civil provisions which operate via the most reliable of human characteristics, self-interest, are the best hope of effectuation of such legislative goals.

> to scholars of judicial administration and to interested parties who stand to gain from an increased ADR market share." [footnotes omitted][58]

Petitioners believe that recent arbitration decisions of this Court, and the pro-arbitration briefs filed by the securities and arbitration industries, are most accurately viewed as "first wave" ADR theory. That first wave theory would appear to contain a focus inappropriate to federal legislative causes of action generally, but specifically inappropriate to the expressly instrumentalist goal[59] of the 1933 Securities Act which was to restore confidence in the investing public.[60]

Since arbitration is inherently non-instrumentalist, Petitioners would thus question the *relevance* of any alleged original or enhanced arbitration to *Wilko* or to the 1933 Securities Act. Petitioners also do not accept the reality of such enhancement nor do Petitioners believe, in any case, that anyone has *affirmatively established* the existence of such alleged enhancement. Since it is clearly demonstrable that there is no equality in technical, procedural attributes,[61] any argument that arbitration is

[58] E. Brunet, *Questioning the Quality of Alternative Dispute Resolution*, 62 TUL. L. REV. 1, 7-8 (1987).

[59] It is to be noted that but for the newspaper coverage of a related case, it is unlikely that these Petitioners would have ever even discovered that they had claims. The industry has an understandable affection for the effective secrecy of the arbitration process.

[60] See, for example, Sen. Rep. 47, 73d Cong., 1st Sess. p. 1 (1933) "The aim is . . . to restore the confidence of the prospective investor . . . "

[61] The following is a non-exhaustive list of procedural deficits of arbitration vis a vis litigation: Jury trial, Article III judges, discovery tools, choices of forum, injunctive relief, and appeal. It is to be noted in relation to the latter, that under the United Kingdom law of arbitration, arbitration agreements may be reviewed by courts for revocability when there is a fraud complaint in the context of a *pre-dispute* agreement. Arbitration Act of 1950, 14 GEO. 6, C. 27, § 24(2), § 25(2) (U.K.). There is

merely a "forum substitute" must thus be cast in terms of result. The problem for Respondent and for the industry is that such argument has never been substantiated empirically.[62] Empirical proof would require that advocates of arbitration establish that the net result of a given arbitration proceeding, from the public customer's standpoint, is equivalent to that result which would be otherwise available through litigation. That proof cannot be manufactured from current arbitration statistics presented to this Court since no serious attempt has been made to document litigation results. All of such proof elements are patently required to prove that the quality of arbitration has *improved* since *Wilko*. Such proof was not offered in *McMahon*.[63]

Without such clear, convincing, *proof*[64] that the arbitration of fraud claims induced by a self-interested fiduciary via an adhesion contract, not meeting the reasonable expectations of the beneficiary, is totally consistent with the *universally* recognized goals of the 1933

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also potential court review via the Arbitration Act of 1979 (1979-c42 U.K.) for certain types of errors of law, errors which have been traditionally reviewable under English jurisprudence.

[62] In its *McMahon* Amicus Brief, the Securities Industry Association advanced the singularly unconvincing argument that "Any lingering doubt as to the efficiency and fairness of arbitration" was "quelled by the history" of the *Phillips v. Merrill Lynch, Pierce, Fenner & Smith Incorporated* arbitration. See *Brief of Amicus Curiae In Support of Petitioners, Shearson/American Express v. McMahon*, No. 86-44, at 9-10.

[63] Respective empirical data from 1953 would surely also be required to substantiate *improvement*. And, of course, any improvement would not be relevant, in any case, to the *Wilko* Court's determination that arbitration is *inherently* impermissible under the 1933 Securities Act.

[64] Such proof is required *not* because of some undisclosed residual judicial distrust of arbitration but rather by adherence to those legal principles requiring that the intent of Congress be imposed upon all.

Securities Act this Court must endorse *Wilko* even upon the erroneous *McMahon* quality premise.

As one commentator has noted, "The prime purpose of the Act is not to punish, hinder, or impede, but to create a new relationship between investors and those who ask to use his savings."[65] Any compulsory predispute arbitration in the context presented in the facts of these cases is not consistent with a "new relationship," rather it is part of that old creed dispatched by this nation's 73rd Congress. The civil weapons carefully provided to investors by the 1933 Act should not be confiscated by this Court with the optimistic judicial instruction that it is safe now to venture into arbitration forums run by the industry – that one no longer has to worry about those in the industry who, in Senator Ashurst's words, "have sunk their fangs into the pocket books of the innocent investors with greater rapacity than a school of sharks ever sank teeth into human flesh." 72 Cong. Rec. 1019 (1933).

IV. PRINCIPLES OF STARE DECISIS DICTATE THAT WILKO NOT BE OVERRULED

1. What *WILKO* Decided

Wilko posed the following legal question:

> . . . whether an agreement to arbitrate a future controversy is a "condition, stipulation, or provision binding any person acquiring any security to waive compliance with any provision" of the Securities Act which § 14 declares "void." [footnote omitted]

Wilko, 346 U.S. at 430.

The Court, having so posed the question, then went on to hold that "This arrangement to arbitrate is a 'stipulation,' and we think the right to select the judicial forum is the kind of "provision" that cannot be waived under section 14 of the Securities Act." *Wilko*, 346 U.S. at 434-5. Having so concluded, the Court stated that " . . . the

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[65] J. Doerfer, *The Securities Act of 1933*, 18 MARQ. L. REV. 147, 171 (1934).

intention of Congress concerning the sale of securities is better carried out by holding invalid such an agreement for arbitration of issues arising under the Act." *Wilko*, 346 U.S. at 438.[66]

Accordingly, including Justice Jackson's concurrence,[67] seven Justices held in *Wilko* that pre-dispute arbitration agreements were *inherently* void under the intent of Congress expressed in the 1933 Securities Act. In the entire majority opinion, and concurring opinion, there appears not one reference to any issue of the *quality* of arbitration, then-extant or otherwise.[68] Indeed there is no direct reference or discussion in the opinion/concurrence of any of the four contractually available arbitration forum options presented on the facts of the case.

That the *Wilko* majority had held that arbitration was *inherently* inconsistent with the Securities Act is further evidenced by the Frankfurter/Minton dissent which began with the reactive:

> If arbitration *inherently* precluded full protection of the rights § 12(2) of the Securities Act affords . . . [emphasis supplied]

Wilko, 346 U.S. at 439.

Following issuance of the *Wilko* opinion there were dozens of case notes and law review articles which uniformly agreed with Petitioners' *Wilko* analysis.[69] Not all

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[66] Petitioners note that *Wilko* dealt with an express cause of action. See *Byrd*, 470 U.S. 225, White, J. concurring.

[67] Which reserved only the question of *post*-dispute agreements to arbitrate.

[68] "There is no mention of this argument of the inadequacies of arbitration [in *Wilko*];" Note, *Securities-Arbitration-Agreements to Arbitrate Are Valid*, 10 U. ARK. LITTLE ROCK L.J. 523,533 (1987-88).

[69] See, for example, Note, *Contracts – Performance And Breach – Whether Arbitration Provision in Stockbrokerage Contract Supersedes Customer's Right to Pursue Judicial Remedy for Violation of Securities Exchange Act*, 32 CHI. KENT. L. REV. 156, 159 (1953-1954).

of the scholarly analysis was necessarily totally supportive of the Court's *Wilko* holding, however there was uniform agreement on *what* that holding had been. That *Wilko* holding has now been cited and accepted in at least 560 *reported* cases.

This *Wilko* ratio was also recognized by this Court in *Scherk* where the majority, in explaining the lower court's reliance on *Wilko*, noted that "*Wilko* . . . held that an agreement to arbitrate could not preclude a buyer of a security from seeking a judicial remedy under the Securities Act of 1933 . . . " *Scherk*, 417 U.S. at 510. The *Scherk* court went on to point out that *Wilko* had held " . . . that an agreement to arbitrate is a 'stipulation' and [that] the right to select the judicial forum is the kind of 'provision' that cannot be waived under § 14 of the Securities Act." *Scherk*, 417 U.S. at 512. The *Scherk* court also noted that there was a "colorable" argument that the 1934 Exchange Act which was before the Court, lacked that "special right" established by § 12(2) of the 1933 Act, *Scherk*, 417 U.S. at 512, and then discussed the 1933 Act's unique jurisdictional provisions. *Scherk*, 417 U.S. at 514. This view of *Wilko*'s holding was also recognized in *Byrd*, 470 U.S. at 224, and was discussed in *McMahon* as well, 107 S. Ct. at 2338.

McMahon, has been viewed as result-oriented jurisprudence[70] wherein the major unarticulated premise is that the case presented the Court with the opportunity to reduce the federal docket.[71] Be that as it may, what the *McMahon* majority could not accomplish, through a rhetorical maze was the defeat of any serious legal analysis whose inescapable conclusion must be that *Wilko* was

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[70] Note, *Who's Protecting the Investors? Shearson/American Express v. McMahon*, 19 ARIZ. ST. L.J. 793, 807 (1987). "The *McMahon* Court's apparent result-oriented reasoning has removed one branch of § 10(b) jurisprudence from public view."

[71] A goal which Petitioners believe to be in any case illusory, particularly under § 11's serial indemnity provisions.

decided on *inherent*,[72] rather than *qualitative*, arbitral characteristics. *Wilko* cannot now be outfitted with a new set of arbitration garments and pushed into retirement with the belief that the retiree can be safely expected to lead an innocuous life thereafter. To do so would not only instantaneously compromise the integrity of the adjudicative process but it would also create the probability of a future reappearances when the inevitable allegations are made that arbitration has deteriorated or that particular arbitration forums do not satisfy the "quality" standard of a retro-fitted *Wilko*.[73]

Petitioners believe, however, that every analysis of the doctrine of stare decisis leads to the inescapable, logical conclusion that *Wilko's* fate should be left to Congress.[74]

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[72] For the view that the lack of equivalent forum choices under the 1934 Exchange Act renders 10(b) claims arbitrable, see Note, *Arbitrability of Claims Arising Under the Securities Exchange Act of 1934*, 1986 DUKE L. J. 548, 566.

[73] Given the arguably greater comparative specificity of the 1933 Act, the practical impact of overruling *Wilko* would surely be to leave *Alexander v. Gardner-Denver Company*, 415 U.S. 36 (1974) (civil rights in employment), *McDonald v. West Branch*, 466 U.S. 284 (1984) (civil rights claim) and *Barrentine v. Arkansas-Best Freight System, Inc.*, 450 U.S. 728 (1981) (Fair Labor Standards Act) as jurisprudential orphans. While the suggestion made in *McMahon* (107 S. Ct. at 2341) is that the new supervisory status of the SEC enhances SRO arbitration forums, Petitioners' view is that the arbitration forums available in *Alexander, McDonald* and *Barrentine* were inherently better than the SEC supervised NYSE and NASD forums available to these Petitioners.

[74] As stated by this Court with respect to its 1950 interpretation of the Federal Tort Claims Act, in justifying adherence to *Feres v. United States*, 340 U.S. 135 (1950), "Nor has Congress changed this standard in the close to 40 years since it was articulated, even though, as the Court noted in *Feres*, Congress 'possesses a ready remedy' to alter a misinterpretation of its intent." *United States v. Johnson*, 107 S. Ct. 2063, 2066 (1987). See

2. Why Stare Decisis Compels Affirmation Of *WILKO*

There is a distinction frequently made and often seen in Supreme Court jurisprudence, between case decisions which involve constitutional questions and case decisions which involve statutory questions.[75] According to those who would make such a distinction, the basic differentiating factor in such distinction is that Constitutional decisions are difficult to alter extra-judicially since alteration would require constitutional amendment, whereas legislative bodies can always respond to statutory decisions.[76] Upon such analysis *Wilko* should now be left to Congress. If Congress disagrees with *Wilko* an amendment to the Securities Act is the simple remedy.

This theory, which is admittedly not entirely free of difficulty, is to the effect that it is the Court's duty to interpret statutes but once having done so, further changes to that interpretive result should be effected by Congress. While it can be argued that Congress ought not to be forced to correct errors made by the Court, or that sometimes it is simply politically not possible to enact such legislative reforms, neither of these arguments is particularly relevant to *Wilko* because there is no evidence that Congress has been unable to effect a legislative reversal nor does *Wilko* present a case of simple legislative acquiescence.

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also, Comments, *Predispute Arbitration Agreements Between Brokers and Investors: The Extension of Wilko to § 10(b) Claims*, 46 MD. L. REV. 339, 377 (1987). "Any policy re-evaluation that would overturn *Wilko* must be left to Congress." The further observation is also made that "The intention of Congress cannot have changed." Id. at 373.

[75] See, for example, *Burnet v. Coronado Oil & Gas Co.*, 285 U.S. 393, 405 (1932), Brandeis J., dissenting.

[76] The deference accorded stare decisis in the field of statutory construction is sometimes described as a "super-strong presumption." See Eskridge, *Overruling Statutory Precedents*, 76 GEO. L. J. 1361, 1366 (1988).

In 1975, in the process of amending the 1934 Securities Act, Congress specifically endorsed *Wilko*.[77] While what that endorsement may have signified *with respect to the arbitrability of 1934 Act claims*[78] is disputed, the reference is clearly supportive of *Wilko* per se. It is to be further noted in that regard that the legislative study preceding the 1975 amendments, and the legislative history of the amendments themselves, contain references to at least fifteen specific court decisions. This close Congressional interaction with court decisions in the securities field, seen in the 1975 amendments, continues. Recent amendments to insider trading laws have, for example, specifically overruled *Moss v. Morgan Stanley, Inc.*, 719 F.2d 5 (2d Cir. 1983).[79]

In his recent law review article, Eskridge has suggested that "The willingness of the Supreme Court to reconsider statutory precedents depends upon: (1) the original thoroughness of the Court's consideration of the issue in the precedent; (2) the degree to which Congress has left development of the statutory scheme to the Courts; and (3) the degree to which the precedent has generated public and private reliance."[80]

If a better analysis or better evidentiary record is available (the "proceduralist" exception), then a legislative precedent may be conformed to the better evidence. The thoroughness of *Wilko* and the exhaustive nature of

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[77] "It was the clear understanding of the conferees that this amendment did not change existing law as articulated in *Wilko v. Swan*, 346 U.S. 427 . . . (1953), concerning the effect of arbitration proceeding provisions in agreements entered into by persons dealing with members and participants of self-regulatory organizations." H.R. Rep. No. 229, 94th Cong., 1st Sess. 111 (1975), *reprinted in* 1975 U.S. Code Cong. & Ad. News 321, 342.

[78] E.g. *McMahon*, 107 S. Ct. at 2343.

[79] See H.R. 5133, 100th Cong., 2nd Sess. (1988).

[80] Eskridge at 1369.

the legislative history of the 1933 Securities Act generally put *Wilko* beyond the reach of this exception.[81]

Under the Eskridge analysis, this Court's second category of exceptions to the "super-strong" presumption favoring statutory precedents are exceptions for "common law" or "constitutionalized" statutes. Under such analysis the Court's more relaxed stare decisis role in *constitutional* cases can be transferred, as it were, to statutes closely related to developing constitutional provisions. Such exception appears inapplicable to *Wilko* since the 1933 Securities Act was expressly limited to those mature constitutional areas of commerce entrusted to Congress.[82]

The exception suggested with respect to "common law statutes" is predicated upon the notion that when Congress adopts sweeping general public policy measures it is *intended* that the Courts have great latitude in interpreting such statutes. Whether or not one accepts the legitimacy of such an exception to the super-strong statutory stare decisis principle, such exception would not encompass *Wilko* on the basis the oft-made observations that the 1933 Securities Act radically *altered* the common

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[81] "*Wilko* was a carefully considered decision by the Court not unmindful of the objectives of the Arbitration Act and the value of commercial arbitration as a procedure voluntarily agreed to in arms-length negotiations. The Court observed that wholesome securities transactions may be arm's length on equal terms, it is clear that the Securities Act was drafted with an eye to the disadvantages under which buyers labor. Issuers of and dealers in securities have better opportunities to investigate . . . than buyers. It is therefore reasonable for Congress to put buyers of securities covered by that Act on a different basis than other purchasers." [footnote omitted] Bloomenthal, H., *Securities Law Handbook, 1987-88 Edition*, (1987) at CXXXIV.

[82] Other views have been historically advanced that the FAA is built upon the Congressional power over federal courts. See, for example, H. Cohen & K. Dayton, *The New Federal Arbitration Law*, 12 VA. L. REV. 265, 275 (1926).

law, creating, for example, the doctrine of caveat *vendi-tor*,[83] and that the Act was highly detailed.

Finally, the third exception to the "super-strong" legislative prohibition – the degree to which a precedent has generated public and private reliance – suggests again that *Wilko* should not be overruled. The fact that *Wilko* existed, unchallenged for at least thirty years,[84] was cited and incorporated in securities jurisprudence by hundreds of reported cases, congressionally endorsed in 1975, and utilized by the Securities and Exchange Commission,[85] all suggests that the public and private reliance level mitigates most strongly against any judicial alteration of *Wilko*.

Accordingly, on a conventional analysis of this Court's approaches to statutory precedent, *Wilko* ought not be overturned.[86]

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[83] See President Roosevelt's Message to Congress, House Document 12, 73d Cong., 1st Sess., at 2 " . . . let the seller also beware . . . "

[84] It is not even clear that before *McMahon* it can be said that *Wilko* per se was even *questioned* by cases like *Byrd*.

[85] See Securities and Exchange Commission Rule 15c2-2, 17 C.F.R. § 240.15c2-2 (now repealed).

[86] Professor Eskridge would substitute on "evolutive" approach to statutory stare decisis, requiring that all three of his "evolutive tests" be satisfied. According to Eskridge his evolutive test is "a hard test to pass." W. Eskridge at 1388. *Wilko* would clearly not pass his evolutive test and would not therefore, under such evolutive analysis, be altered. For an exhaustive listing of post-1961 relevant case authorities see Eskridge, appendices A-C, *id.* at 1427-39.

Petitioners believe that *Wilko* presents the least theoretically desirable set of facts[87] for precedential overturning and Petitioners further believe that if the Court overrules *Wilko*, public concern as to the overall agenda of this Court, already at a high level, will further increase.

Finally it is instructive that the *McMahon* decision prompted a negative Congressional response.[88]

V. ANY *WILKO* CHANGE SHOULD NOT BE APPLIED RETROACTIVELY

Apart from the contractual intent issue, there remains the broader policy issue of retroactivity. If *Wilko* is to be overruled, should the new rule be applied to all section 12(2) claims regardless of when they arose? It would appear that this Court has traditionally looked to several factors in deciding whether it will retroactively apply a rule enunciated in a case overruling an earlier statutory precedent. Those factors are the extent to which others have justifiably relied on the old rule,[89] the extent to which the new rule's effectiveness is tied to retroactivity,[90] and whether or not retroactive application will pose an administrative burden.[91]

With respect to these Petitioners, who had no intent other than the general intent to place their full trust in Respondent, it is admittedly somewhat difficult to argue *directly* that any *Wilko* change should be prospective only

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[87] Petitioners would suggest, for example, that *Roe v. Wade*, 410 U.S. 113 (1973), presents in logical terms a much more legitimate role for precedential review since unborn children will never have the voice with which to effect constitutional amendment.

[88] See H.R. 4960, 100th Cong., 2nd Sess. (1988).

[89] E.g. *England v. Louisiana State Board of Medical Examiners*, 375 U.S. 411, 422 (1964).

[90] E.g., *Linkletter v. Walker*, 381 U.S. 618, 629 (1965).

[91] E.g., *Johnson v. New Jersey*, 384 U.S. 719, 731 (1966).

because Petitioners *relied* on *Wilko*. However, it *can* be argued that included in Petitioners' trust placed on Respondent, was Petitioners' expectation that Respondent would abide by all relevant laws.[92] Accordingly it is legitimate to argue that, in essence, Petitioners did rely on *Wilko*. It is also true that there would be a significant number of investors with some requisite level of sophistication who signed similar contracts and that *those* investors relied on *Wilko* and that any change in *Wilko*, for that reason, should be *prospective* only. Certainly any such reliance by such investors was fully justifiable since *Wilko* had been in existence for some thirty years, had been Congressionally endorsed in 1975[93] and had been repeatedly explained in the law reviews.[94]

A further retroactivity consideration used by this Court has been the extent, if any, to which any change should be applied retroactively so as to effectuate the new ruling's objective. Since any total reversal of *Wilko* would presumably be to further the goal of the 1925 Arbitration Act to permit parties to agree to arbitrate such disputes as affecting maritime transactions or interstate commerce, considering the contractual intent issue

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[92] Which the document itself suggests would be the case (the form provision read: "Unless unenforceable due to federal or state law, any controversy arising out . . . shall be settled by arbitration").

[93] H.R. Rep. No. 229, 94th Cong., 1st Sess. 111 (1975).

[94] See, for example, *Arbitration Under the Securities Act of 1933*, 49 NW L. REV. 101, 101-3 (1955). "In a recent opinion the Supreme Court finally settled a conflict between the Federal Arbitration Act and the Securities Act of 1933 . . . Mr. Justice Reed, for the majority, reasoned that because the security buyer has so wide a choice of courts and venue, he gives up more than participants in other business transactions when he waives his rights to sue in Courts." [footnotes omitted]

discussed below, it would seem particularly inappropriate to view retroactivity as essential to the furtherance of the new rule's objectives.

Nor would it appear that retroactivity would be dictated under the Court's analysis of the benefit to the administration of justice. Because the applicable § 12(2) statute of limitations period is so short,[95] few existing cases will still be able to utilize *Wilko*, and of that finite number, most could be further purged from the federal docket if prospectivity were imposed as of the date of the *McMahon* decision,[96] a point in time which arguably can be advanced as at least more appropriate.[97]

VI. ANY ALTERATION OF *WILKO* SHOULD NOT BE APPLIED TO THIS CATEGORY OF INVESTOR

Petitioners' overall position is that there are *no* valid agreements to arbitrate in these specific cases. Not only

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[95] Under § 13, the period is basically one year. See *Cook v. Avien, Inc.*, 573 F.2d 685 (1st Cir. 1978).

[96] The retroactive application of *McMahon* to 10(b) claims, seen for example in *Peterson v. Shearson/American Express*, 849 F.2d 464 (10th Cir. 1988) reflects that this Court had never, prior to *McMahon*, ruled an arbitrability of such 10(b) claims. Such facts are radically different from 12(2) claims under the 1933 Act which as noted, have been non-arbitrable under *Wilko* for more than 35 years, and, together with all of the previously noted and relevant stare decisis issues discussed previously, constitute the variety of injustice that would dictate non-retroactivity under *Saint Francis College v. Al-Khazraji*, ___ U.S. ___, 107 S.Ct. 2022, 2025 (1987).

[97] Admittedly, of course, retroactive application (unlike the retroactive application of expanded criminal constitutional rights) might reduce *court* dockets, however, awards will have to be enforced in court.

were the contractual documents adhesive in nature[98] they were also contextually oppressive, substantively unconscionable and beyond the reasonable expectations of Petitioners.[99] The fact is that these investors were either unable to read or comprehend the documents and/or

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[98] The industry overwhelmingly required arbitration in this type of margin agreement. As noted by a SEC official, "Virtually every securities firm in the United States – at least of any appreciable size – uses pre-dispute arbitration clauses, at least in contracts having to do with options and margin trading." 20 Sec. Reg. & L. Rep. (BNA) 101 (Jan. 22, 1988) As shown by the record in this case, this arbitration clause was not a separate portion of the document. With respect to securities industry form documents as contracts of adhesion, see generally, Sterk, *Enforceability of Agreements to Arbitrate: An Examination of the Public Policy Defense*, 2 CARDOZA L. REV. 481 (1981), A. Goldberg, *A Supreme Court Justice Looks At Arbitration*, 20 ARB. J. 13, 16 (1965) (stressing the need to ensure that agreements truly are "voluntary") and J. Di Fiore, *Problems in Alternative Dispute Resolution: Arbitration Agreements as Contracts of Adhesion in Consumer Securities Disputes*, 93 COM. LAW J. 259 (1988).

[99] For a provocative discussion of form contracts and reasonable expectations of the parties, see W. Slawson, *The New Meaning of Contract: The Transformation of Contracts By Standard Forms*, 46 U. PITT L. REV. 21, 35 (1984) where the author suggests that even a commercial buyer " . . . does not expect a requirement that he subject himself to arbitration in a forum of the seller's choice . . . " Slawson's basic thesis is that "the application of well-established common law principles led to the conclusion that standard forms as they were commonly used were not contracts." Id. at 38. It seems highly ironic that the law of merchants offers more protection to the sophisticated businessman than does federal securities law to the unsophisticated investor. See generally, J. Mallor, *Unconscionability In Contracts Between Merchants*, 40 SW L. J. 1065 (1986).

were prevented from making even an attempt to physically examine them.[100] Respondent was bound by not only the trust relationship which was *expressly* verbally extended to each Petitioner, but which is also imposed by the 1933 Act itself.[101]

Accordingly, while the reality is that there were no agreements to submit any of Petitioners' claims to arbitration, however, to the extent that such reality may be contested, Petitioners are compelled to discuss here the *fiction* of the contractual meeting of the minds.

As noted by the Securities and Exchange Commission in their *McMahon* amicus brief[102] arbitrability of

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[100] The following quotation distills some of the important realities touching pre-dispute clauses: "Since much of the [form] agreement looks like legal boilerplate, many investors will not bother to read it. Because they believe the government strictly regulates brokerage houses to insure consumer protection from fraud or unfair dealing, most will not take the agreement to an attorney. They also presume every other investor must and does sign similar agreements . . . Even investors who know they are agreeing to arbitration may not be quite sure what it is." [footnote omitted]. P. Shub, *Shearson/American Express v. McMahon: The Expanding Scope of Securities Arbitration*, 12 NOVA L.REV. 1375, 1375-7 (1988).

[101] The legislative history and relevant law review commentaries are replete with the Brandeis thesis that those who handle "other people's money" have fiduciary duties. As noted elsewhere, President Roosevelt's message to Congress concerning the 1933 Act concluded with the theme of such Act: "those . . . handling or using people's money are trustees acting for others." See J. Landis, *The Legislative History of The Securities Act of 1933*, 28 GEO. WASH. L. REV. 29, 30 (1959-60). "It [the 1933 Act] indicted a system as a whole that had failed miserably in imposing those essential fiduciary persons whose function it was to handle other people's money."

[102] Amicus Brief, Securities and Exchange Commission, *Shearson/American Express v. McMahon*, No. 86-44, p. 18, n. 13.

securities fraud claims even under the 1934 Exchange Act, present problems of contractual intent. If one indulges in the fiction that these (or any other investors) both read *and* understand the fine print which purports to adopt arbitration, there remains the further question of whether or not the parties would have *intended* to subject to arbitration, claims which, at point of execution, were clearly not arbitrable but which later might become so.

In the context of § 10(b) claims, perhaps there is some argument that since this Court had not, prior to *McMahon*, definitively ruled one way or the other on arbitrability, that pre-*McMahon* arbitration provisions, in light of an alleged strong pro-arbitration interpretive rule, may be viewed as encompassing § 10(b) fraud claims. Be that as it may, when *these* Petitioners signed relevant documents in 1982 and 1983, it was unchallenged that § 12(2) claims could not be arbitrated *and* that *Wilko* had held any such agreement to be *void*.[103] Something void cannot be resurrected and, in any case, the miracle drug arguably manufactured in *Mitsubishi* and perhaps later in *McMahon*, came too late for *this* Respondent.

If a lawyer had been asked by one of these Petitioners, in 1983, whether or not they could sign a document and still be entitled to litigate § 12(2) claims, the answer would have been a very confident "yes." If an attorney could not rely on *Wilko* as a clear statement of

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[103] Section 14 of the 1933 Act utilizes the term "void". The *Wilko* majority, of course, used the term "invalid." *Wilko*, 346 U.S. at 438. For a discussion of validity, voidness, voidability, and unenforceability in the context of the U.S. Arbitration Act, see Comment, *Fraudulent Inducement As A Defense to the Enforcement of Arbitration Contracts*, 36 YALE L. J. 866 at 869-71 (1926-1927). Petitioners note that § 2 of the U.S. Arbitration Act concludes with "revocation" notwithstanding the fact that such term is preceded by a reference to *three* concepts – "valid," "irrevocable," and "enforceable."

the law in 1983, then the question which surely must be asked is when could any lawyer *ever* give competent advice? Clearly the answer to the overall fiction is that Petitioners could not have *intended* to arbitrate § 12(2) claims nor was the law such as to even make them *competent* to do so.

CONCLUSION

Based on all of the foregoing reasons, the judgment of the United States Court of Appeals for the Fifth Circuit should be reversed and Petitioners' 12(2) claims under the 1933 Securities Act ordered tried in federal district court.

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Brownsville, Texas

Respectfully submitted,

DENIS A. DOWNEY
Counsel of Record for Petitioners
1185 F.M. 802, Suite 3
Brownsville, Texas 78521
(512) 544-0561

BY: Denis A. Downey
Bar Card No. 06085500
Fed. Dist. No. 1186

APPENDIX A

STATUTORY AND REGULATORY PROVISIONS INVOLVED

United States Arbitration Act

9 U.S.C. § 2:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

9 U.S.C. § 3:

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

Securities Act of 1933

Section 12(2), 15 U.S.C. § 77l(2):

> Any person who –
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> * * *
>
> (2) offers or sells a security (whether or not exempted by the provisions of section 77c of this

title, other than paragraph (2) of subsection (a) of said section), by the use of any means or instruments of transportation or communication in interstate commerce or of the mails, by means of a prospectus or oral communication, which includes an untrue statement of a material fact or omits to state a material fact necessary in order to make the statements, in the light of the circumstances under which they were made, not misleading (the purchaser not knowing of such untruth or omission), and who shall not sustain the burden of proof that he did not know, and in the exercise of reasonable care could not have known, of such untruth or omission,

shall be liable to the person purchasing such security from him, who may sue either at law or in equity in any court of competent jurisdiction, to recover the consideration paid for such security with interest thereon, less the amount of any income received thereon, upon the tender of such security, or for damages if he no longer owns the security.

Section 14, 15 U.S.C. § 77n:

Any condition, stipulation or provision binding any person acquiring any security to waive compliance with any provision of this subchapter or of the rules and regulations of the Commission shall be void.

Section 22(a), 15 U.S.C. § 77v(a):

The district courts of the United States and United States courts of any Territory, shall have jurisdiction of offenses and violations under this subchapter and under the rules and regulations promulgated by the Commission in respect thereto, and, concurrent with State and Territorial courts, of all suits in equity and actions at law brought to enforce any liability or duty created by this subchapter. Any such suit or action may be brought in the district wherein the defendant

is found or is an inhabitant or transacts business, or in the district where the offer or sale took place, if the defendant participated therein, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No case arising under this subchapter and brought in any State court of competent jurisdiction shall be removed to any court of the United States. No costs shall be assessed for or against the Commission in any proceeding under this subchapter brought by or against it in the Supreme Court or such other courts.

Securities Exchange Act of 1934

Section 10, 15 U.S.C. § 78j(b):

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange –

* * *

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Section 27, 15 U.S.C. § 78aa:

The district courts of the United States and the United States courts of any Territory or other place subject to the jurisdiction of the United States shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all

suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder. Any criminal proceeding may be brought in the district wherein any act or transaction constituting the violation occurred. Any suit or action to enforce any liability or duty created by this chapter or rules and regulations thereunder, or to enjoin any violation of such chapter or rules and regulations, may be brought in any such district or in the district wherein the defendant is found or is an inhabitant or transacts business, and process in such cases may be served in any other district of which the defendant is an inhabitant or wherever the defendant may be found. Judgments and decrees so rendered shall be subject to review as provided in sections 1254, 1291, 1292, and 1294 of Title 28. No costs shall be assessed for or against the Commission in any proceeding under this chapter brought by or against it in the Supreme Court or such other courts.

Section 29(a), 15 U.S.C. § 78 cc(a):

> Any condition, stipulation, or provision binding any person to waive compliance with any provision of this chapter or of any rule or regulation thereunder, or of any rule or an exchange required thereby shall be void.